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OGI International Financial Situation Report #25S

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Argentina: Attempting to Resolve the Debt Crisis

We expect the Argentines and their creditors will resolve their immediate problem of prolonged overdue interest charges, perhaps based on a tentative agreement with the IMF. Even so, future bank negotiations will be contentious and hold considerable potential for a breakdown and a consequent international crisis. [redacted] 25X1

Immediate Danger

Unless Argentina makes substantial interest payments by 30 March--estimates range from $600 million to 1.2 billion--many of their loans will be in arrears longer than 90 days. US banks which hold Argentine loans will be forced, under current banking regulations, to reclassify about one-half of their $8.4 billion Argentine loan portfolios as non-performing. [redacted] 25X1

We believe that Buenos Aires is unwilling to deplete its reserves or sell gold to meet the March deadline. First, we estimate Argentia has less than $1 billion in liquid assets. The Alfonsin administration is unlikely to exhaust the Treasury or sell gold to meet the March deadline and leave itself vulnerable to charges by the potent Peronist opposition of a

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sellout to the international financial community. Further, the administration is keying off the precedent established in December 1983, when it averted a similar problem. Bankers then granted Buenos Aires the first $500 million tranche of a $1.5 billion medium-term loan, ostensibly as a show of support for the newly-elected Alfonsin government. The Argentines returned the entire amount of the disbursement plus enough of their own reserves to cover the first $350 million payment against a $1.1 billion bridge loan and to bring interest payments current through early October. 25X1

Search for Solutions

Press reports indicate that the Argentine bank advisory committee is meeting now to resolve the issue. Two proposals probably are being considered. In mid-February, the US Embassy reported that the committee was willing to disburse the remaining $1 billion of the medium-term loan arranged last year if the Managing Director of the IMF would recommend a new letter of intent for approval by the Fund board. Alternatively, Economy Minister Grinspun already suggested in January that the bank consortium disburse the remaining $1 billion in the medium-term facility without a firm IMF accord. Argentina would return the entire disbursement plus enough of their reserves to make a $350 million bridge loan payment due shortly and bring interest payments current through year end. Grinspun pointed out that this plan of action would

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remove the time pressure on the bankers and free him to concentrate on his goal of obtaining formal IMF and Paris Club accords and a comprehensive bank rescheduling by 30 June. [redacted] 25X1

There are several roadblocks to an expeditious solution. Based on talks to date and the apparent Argentine tactic of postponing comprehensive planning to gain maximum negotiating flexibility, we doubt Grinspun will have a firm IMF letter of intent in time to allow a disbursement by 30 March. For example, Grinspun has yet to seek Congressional agreement on a budget which must be the linchpin of any IMF accord. We anticipate Grinspun will encounter tough domestic opposition to the budget unless it avoids major slashes in the public sector deficit and thus averts the appearance of strict austerity. Moreover, we believe the Fund's technical staff will find internal inconsistencies in the first Argentine budget that surfaces. The US Embassy reports that Grinspun is working with little technical support in drawing up the budget and is further handicapped by the absence for heart surgery of Central Bank President Garcia Vasquez who would normally share work on the debt problem. [redacted] 25X1

Because Buenos Aires has yet to frame a comprehensive economic program, substantive disagreements with the Fund will likely arise. The US Embassy reports that clashes with the Fund over exchange rate adjustment and tight credit policies have already taken place. Alfonsin has continued the policy of

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small daily devaluations each business day to keep the exchange rate in line with inflation. We expect Buenos Aires to stand firmly against any suggestions of a large one-time devaluation because of its inflationary effect through higher import prices. We believe Grinspun will also hold out for a level of credit expansion commensurate with supporting private firms in an economic recovery, which could further delay an agreement.

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Even if Grinspun overcomes or postpones all of these problems and a tentative agreement is reached, administrative and other delays will ensue. The bank advisory committee must send telexes and await approval from some 300 consortium members. Only US bankers are subject to the end-March deadline and some other banks appear less willing to rush into a loan. Lloyd's Bank, speaking for UK banks, continues to suggest that the $1 billion drawing be conditional on formal approval of the IMF board--which would delay disbursement until late April. In order to bring UK banks on board, Grinspun probably would have to modify current exchange policies which are discriminating against dividend remittances to British firms. 25X1

We believe Grinspun calculates, however, that even perceived progress toward an IMF letter of intent will provide enough working room--with US help--for a temporary solution to avert technical default. We would expect an Argentine appeal for relaxed or revised US banking regulations or a US Treasury

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bridge loan to help the new government resolve its inherited financial problems. Thus, by the end of April at the latest, Buenos Aires probably expects to settle the initial interest arrears problem. 25X1

Further Obstacles Ahead

Argentina's approach has several risks for the remainder of 1984, given upcoming debt rescheduling talks for $20 billion due to be paid this year. Should agreement not be achieved this quarter, US banks will suffer substantial earnings losses. We expect that, as a result, the banks would take a much harder line when Buenos Aires enters formal discussions concerning rescheduling 1982-84 maturities and new loans. Even if a patchwork solution is found, Argentina's tactics have annoyed international bankers, and they will be attempting to head off a repeat performance in the full rescheduling talks. Alfonsin and Grinspun meanwhile will be bound by campaign and post-election promises to obtain terms which improve upon those offered to their military predecessors and match or exceed the most favorable agreements with other Latin American debtors. They will not accept terms which either appear to impinge on national sovereignty or inhibit the growth potential of the economy. With banker positions hardening, a major confrontation is increasingly probable. An impasse would create serious problems if it stalled talks for more than a few weeks. 25X1

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Hardline Sentiments

Alfonsin's failure to lay out a comprehensive set of economic policies during three months in office has fostered the development of a hardline group on debt within his Radical Party and encouraged them to assert their views. This group would likely seize upon any confrontation with banks or the IMF to further enhance its position. [redacted] 25X1

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The extent of support for an ultranationalist approach within the President's inner circle is still not clear. Some Argentines believe the tough talk is a psychological ploy. [redacted] 25X1

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policy, one danger is that strident rhetoric could spawn its own constituency--a popular Argentine movement with a momentum all its own demanding a tough political stance by the Alfonsin government. [redacted] 25X1

Argentina is widely recognized as the major debtor most able to walk away from its debt without suffering disastrous consequences. It is a substantial food exporter to the Soviet bloc, ensuring a large foreign earnings base to pay for necessary imports. It is also nearly self-sufficient in petroleum. Regional pressures on Alfonsin to assume leadership among Latin American debtors have already surfaced. Should an initial breakdown in talks with lenders strengthen the hand of hardline nationalists, Alfonsin could move precipitously, setting the stage for both major losses by banks and a crisis in the international financial system. [redacted] 25X1

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